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No. 97-1625

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

CALIFORNIA DENTAL ASSOCIATION,

Petitioner,

v.

FEDERAL TRADE COMMISSION,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION

RAOUL RENAUD
CALIFORNIA DENTAL ASSOCIATION
1201 K Street Mall
P.O. Box 13749
Sacramento, CA 95853
(916) 443-0505

PETER M. SFIKAS
Counsel of Record
SCOTT M. MENDEL
ERIK F. DYHRKOPP
EDWARD M. GRAHAM
BELL, BOYD & LLOYD
70 West Madison Street
Suite 3300
Chicago, IL 60602-4207
(312) 372-1121

Attorneys for Petitioner

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I. THIS COURT SHOULD RESOLVE THE CONFLICT OVER THE COMMISSION'S JURISDICTION

The Commission cannot deny that the Ninth Circuit explicitly found that "[a]mong the other circuits there is a split on the [jurisdictional] issue . . . ." App. 15a. Likewise, the Commission cannot contradict this Court's previous grant of *certiorari* to resolve the conflict. *American Medical Ass'n v. FTC*, 638 F.2d 443 (2d Cir. 1980), *aff'd by an equally divided Court*, 455 U.S. 676 (1982). In its Opposition, the Commission makes two erroneous arguments: that *Community Blood Bank v. FTC*, 405 F.2d 1011 (8th Cir. 1969), held that only "charitable organizations" are exempt from the FTC Act and that the legislative history supports the Commission's jurisdiction over nonprofit professional associations. Opp. 11-15.

In *Community Blood Bank*, the Eighth Circuit criticized the FTC for differentiating between for profit and nonprofit corporations for the purpose of defining the language "organized to carry on business for its profit." The court noted that the Commission interpreted "profit" in a for profit corporation to mean it was organized in order that its shareholders have an equity interest in the corporation and its income and that they have an entitlement to share in the profits and in the assets upon dissolution. 405 F.2d at 1016. On the other hand, the Commission interpreted the "for profit" phrase for nonprofits more broadly because generally nonprofits do not distribute profits and their members are not entitled to the corporation's assets upon dissolution. *Id.* The court also found the legislative history "not too illuminating" but did observe that neither the legislative history nor the language of the Act supports the Commission's contention that Congress intended "profit" to be given different interpretations depending upon the character of the

corporation under consideration. *Id.* at 1016-17. It observed:

> [B]y limiting the corporations to be embraced within the provisions of the Act, Congress intended to exclude some corporations from the Commission's jurisdiction.

Id. at 1017.

The court determined that the Act applied to a for profit or nonprofit if the entity engages "in business for *profit* within the traditional meaning . . . of that word" and that "profit" was gain from business or investment over and above expenditures, paid or contemplated to be paid to its shareholders or members. *Id.* It specifically defined the jurisdictional test as whether "a corporation without shares of stock . . . engages in business for *profit* within the traditional and generally accepted meaning of that word." *Id.* The record in this case is clear; CDA does not engage in business and has not paid any "profits," as defined by *Community Blood Bank*, to its members.

The Eighth Circuit's holding in *Community Blood Bank* is more expansive than the Commission's artificially narrow reading of the decision as exempting only charitable organizations.[1] The court's summary of its holding on the last page of the opinion succinctly states:

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[1] The *Community Blood Bank* court uses the terms nonprofit and charitable organization interchangeably. 405 F.2d at 1019-20. However, it is clear that no matter the term used to describe the entity, the distinguishing fact is not whether the nonprofit is a charity but whether the entity conducts business, makes a profit (as that term is traditionally and generally accepted) and either pays the profit to its shareholders or intends to do so. *Id.* at 1017. If the Commission were correct that *Community Blood Bank* only speaks to charitable organizations, the Ninth Circuit would not have found a "split" among the circuits. App. 15a. The cases relied upon by the Commission for the contention that many courts have entertained cases against trade or professional associations, Opp. 14-15, are not persuasive in that either the jurisdictional issue was not raised or the courts adopted the logic of

> 3. That the corporate petitioners are true nonprofit corporations, not engaged in business for profit for themselves or their members.
> 4. That the Commission lacks jurisdiction over all of the petitioners.

405 F.2d at 1022.

The Commission's reliance on the legislative history discussion in *Community Blood Bank* is misplaced. Opp. 11-12. Initially, the Commission fails to address the threshold issue of whether the plain language of the Act even permits an examination of the legislative history.[2] The Commission argues that the addition of "corporations without capital stock" to the Act was meaningful. Opp. 11. However, since it is clear under *Community Blood Bank* that the Act applies to both for profit and nonprofit entities which engage in business to make a profit and then distribute it to their members or shareholders, the addition of the language "corporations without capital stock" is irrelevant for the purpose of answering the jurisdictional test in this case.[3]

Despite the clear holding in *Community Blood Bank*, neither the Commission nor the Ninth Circuit made the appropriate inquiry into whether the CDA engaged in business to make a profit as that term is traditionally defined. Rather the Commission, to eviscerate Congressional intent, has used as a surrogate for "profit" the provision of

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Community Blood Bank that in these cases the organizations derived a "profit" in the traditional meaning of the term. *See* 405 F.2d at 1019.

[2] *Cf. Pennsylvania Dep't of Corrections v. Yeskey*, 66 U.S.L.W. 4481, 4482-83 (U.S. June 15, 1998).

[3] The legislative history to which the Commission cites is a letter from Joseph E. Davies, then Commissioner of the predecessor of the Federal Trade Commission, to Senator Newlands, the author of the Senate version of the Act. 405 F.2d at 1017. Mr. Davies' letter referred only to commercial associations of manufacturers or dealers, not professional associations. *Id.* at 1017-18.

"tangible, pecuniary benefits to its members." App. 16a. The Commission's approach is a clear violation of the language of the Act and Congressional intent and therefore should be reviewed by this Court.

Congress unequivocally understood how to enact antitrust legislation which covered all corporations, but it did not do so with the FTC Act. 405 F.2d at 1018.[4] Moreover, in 1977 when the FTC gave Congress another opportunity to include nonprofits which do not conduct business to make and distribute a profit in Section 4 of the Act, Congress declined. CDA Pet. 14-15.

This Court previously recognized the importance of accepting *certiorari* to resolve the question of whether the Commission's jurisdiction extends to nonprofit professional associations. *American Medical Ass'n*, 455 U.S. at 676. Congress plainly provided jurisdiction to the Commission over commercial and business associations and did not intend to include nonprofit professional associations such as CDA.

II. THIS COURT SHOULD RESOLVE THE CONFLICT OVER THE "QUICK LOOK" RULE OF REASON

The Ninth Circuit used an abbreviated rule of reason to strike down conduct which had no adverse effect on competition and which had a valid, procompetitive purpose. Its improper use of the so-called "quick look" places it in conflict with the decisions of this Court and the Third and Seventh Circuits.

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[4] The Commission's reliance on *In re College Football Ass'n*, 117 F.T.C. 971 (1994), Opp. 13, is surprising because it did not argue this decision of the FTC before the Ninth Circuit and the court made no reference to it in its opinion. In any event *College Football* represents the Commission's erroneously narrow reading of *Community Blood Bank*.

The Commission tries to muddy this conflict by characterizing the Ninth Circuit's ruling as merely approving "detailed factfinding" and "context-sensitive" legal analysis. Opp. 16. In fact, both the Ninth Circuit's and Commission's decisions ignored the only "detailed factfinding" that is central to this case - the ALJ's finding that CDA's Code of Ethics had no adverse impact on competition. This finding was dictated by the record, as "complaint counsel have not produced any convincing evidence that CDA members have acted or could act together to raise prices or reduce output . . . ." App. 262a. The Commission did not even proffer expert testimony on competitive effects. After trial, the ALJ adopted the testimony of CDA's expert, Dr. Knox:

> [T]he activities of [CDA] with respect to their enforcement of their Code of Ethics relative to advertising has no impact on competition in any market in the State of California, particularly with respect to price and output.

App. 246a.[5]

The Commission majority disregarded these express findings, replacing facts with a presumption that CDA's conduct had anticompetitive effects. Rather than a "detailed" or "context-sensitive" approach, the Commission majority conceded that its analysis was "simple and short." App. 74a. Its conclusion - that the competitive effects were "plain" - was based solely on the nature of the conduct at issue. The Commission expressly declined to quantify any increase in prices or decrease in output. App. 78a. As Commissioner

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[5] The Commission now asserts that the ALJ did not adopt Dr. Knox's testimony but merely summarized it. Opp. 16. However, the ALJ quoted portions of Dr. Knox's testimony as part of his findings of fact. App. 246a. Also, the ALJ reiterated his agreement with Dr. Knox's testimony when he concurred that there was no evidence that CDA members had raised or could collectively raise prices or restrict the output of dental services. App. 262a.

Azcuenaga noted, complaint counsel "did not offer evidence . . . on fundamental elements of a rule of reason analysis . . . ." App. 110a. The total lack of evidence led to her conclusion that "it is 'implausible at best' that CDA has had any significant adverse effect on competition." App. 146a.

One commentator explained the inadequacy of the evidence upon which the Commission now relies:

> In all, this evidence merely established that some consumers responded to some dentists' advertisements by using their services. It could not establish that this type of advertising fostered competition or that consumers who got their information on the quality of dental care from dentists' advertisements had to do without such advertising.
>
> . . . .
>
> . . . The fact that particular dentists who drew patients by claiming to practice "gentle dentistry" could not make such claims by virtue of a restriction does not tell us whether the restriction actually affected competition
>
> . . . .

Joseph Kattan, *The Role of Efficiency Considerations in the Federal Trade Commission's Antitrust Analysis*, 64 ANTITRUST L. J. 613, 631-32 (1996).[6]

The Ninth Circuit majority took the same approach as the Commission, using an abbreviated rule of reason to

[6] The Commission seeks support for its abbreviated rule of reason analysis in its "finding" that the CDA has market power. Opp. 18 n.8. Commissioner Azcuenaga eviscerated this "finding" in her dissent, concluding that "[t]he evidence of market power here is so sparse and superficial as to be virtually nonexistent." App. 110a. Further, as the Commission points out in its brief, market power is merely a surrogate for determining whether a party has the power to raise prices or restrict output. Opp. 18 n.8. In this case, it is inappropriate to rely on a surrogate because the ALJ determined that CDA's conduct has not raised prices or restricted output.

summarily condemn the very conduct the ALJ found had no effect on the prices or output of dental services. In his dissent, Judge Real pinpointed the majority's error: "[T]he majority finds a restraint on competition without the supporting help from any of the economic principles . . . ." App. 26a. Far from relying on the specific facts of record, the Ninth Circuit (and the Commission) struck down CDA's conduct using a myopic approach which ignored the facts and misapplied the law.[7]

Its use of the "quick look" places the Ninth Circuit in direct conflict with *NCAA v. Board of Regents*, where this Court expressly reserved a shortened analysis for "naked" restraints on price or output for which there are no procompetitive justifications. 468 U.S. 85, 109 (1984). The Ninth Circuit's opinion goes beyond these limits. The court conceded that CDA's policies "do not, on their face, ban truthful, nondeceptive ads" and that "the economic impact of the restraints is not immediately obvious." App. 17a-18a. With this acknowledgment, a full rule of reason analysis was required. Judge Real emphasized this point: "[t]he rules of the CDA . . . are not . . . sufficiently anti-competitive on their face to eschew a full-blown rule of reason inquiry." App. 25a.[8]

[7] The Commission implies that the Court should ignore the ALJ's findings because the Commission's review was plenary. Opp. 16. This is a red herring. The Commission did not disavow the ALJ's finding of no competitive effect and it made no direct findings of such an effect. App. 78a. Instead, it inferred competitive effect from the nature of CDA's conduct. This inference, in the face of the ALJ's specific findings, was legal error. *See, e.g., Boise Cascade Corp. v. FTC*, 837 F.2d 1127, 1143-45 (D.C. Cir. 1988) (Commission not free to apply inference of competitive injury in face of contrary ALJ findings).

[8] The Commission belatedly attempts to squeeze within the narrow holding of *NCAA* by asserting that CDA's practices amounted to an "output limitation" as they supposedly "restrict[ed] the supply of information . . . ." Opp. 19. However, the market at issue is dental

The Ninth Circuit's decision also conflicts with Judge Easterbrook's decision in *Illinois Corporate Travel, Inc. v. American Airlines, Inc.*, 806 F.2d 722 (7th Cir. 1986), and the Ninth Circuit's previous decision in *American Ad Management, Inc. v. GTE Corp.*, 92 F.3d 781 (9th Cir. 1996). In both cases, the courts refused to apply an abbreviated rule of reason because the practices at issue were not, on their face, restraints on price or output.[9]

The Ninth Circuit also placed itself at odds with the Third and Seventh Circuits by applying the "quick look" after CDA had proffered a procompetitive rationale. The Court of Appeals agreed that the purpose of CDA's ethical rules is to "prevent[] false and misleading advertising." App. 18a. Confronted with this procompetitive end, the Commission was required to conduct a full-scale analysis of competitive effects, as in *United States v. Brown Univ.*, 5 F.3d 658, 678 (3d Cir. 1993), and *Vogel v. American Soc'y of Appraisers*, 744 F.2d 598 (7th Cir. 1984).[10]

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services and the ALJ found that the supposed restriction on information did not restrain the output of dental services. App. 82a, 262a.

[9] The Commission attempts to distinguish these decisions as involving vertical restraints. Opp. 21 & n.10. *American Ad Management* involved an alleged horizontal agreement among competitors. 92 F.3d at 784-85. In *Illinois Corporate Travel*, the court held that a vertical prohibition against discount advertising was "functionally" a price restriction, but its potential economic benefits precluded summary condemnation. 806 F.2d at 728-29. As CDA's advertising rules also have economic benefits, the vertical nature of *Illinois Corporate Travel* does not distinguish it from this case.

[10] The Commission ignores *Brown* except to state that the Third Circuit required a full rule of reason analysis after a procompetitive rationale was tendered by the defendant, while the Ninth Circuit did not. Opp. 21. Rather than distinguishing *Brown*, this is an admission that the two courts applied conflicting legal standards. As for *Vogel*, the Commission suggests that the Seventh Circuit merely refused to find that the restraint at issue was *per se* illegal. Opp. 22. Not so. Judge Posner expressly declined to invalidate an ethical bylaw under a "quick look," requiring a full rule of reason analysis. 744 F.2d at 603-04.

Contrary to the Commission's claim, *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986) ("*IFD*"), does not support summary condemnation of CDA's conduct. In *IFD*, a group of dentists organized a "union" solely to evade the antitrust laws. It promulgated a "work rule" which prohibited members from supplying x-rays to insurers. This Court held that such transparently anticompetitive conduct violated the rule of reason because it caused "actual, sustained adverse effects on competition." *Id.* at 461.[11]

Had either the Commission or Ninth Circuit conducted a full rule of reason inquiry in this case, it could not have condemned CDA's conduct. The ALJ found that complaint counsel had failed to satisfy the rule of reason as there was no adverse effect on price or output. App. 245a, 246a, 262a. Because "the criterion to be used in judging the validity of a restraint on trade is its impact on competition," the Ninth Circuit's use of an analytical short-cut to strike down CDA's practices where no impact was shown, turns the rule of reason on its head. *See NCAA*, 468 U.S. at 104.

The Commission does not dispute the public importance of CDA's Petition. By departing from *NCAA* and creating a split within the circuits, the Ninth Circuit majority has caused uncertainty regarding when and how the abbreviated rule of reason will be applied. Uncertainty in the application of the antitrust laws chills lawful, efficient business practices. *United States v. Philadelphia Nat'l Bank*, 374

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[11] The Commission wrongly claims that the Ninth Circuit's abbreviated rule of reason is in harmony with other courts of appeal. Opp. 20 n.9. In *Law v. NCAA*, 134 F.3d 1010, 1020 (10th Cir. 1998) and *Chicago Professional Sports Ltd. Partnership v. National Basketball Ass'n*, 961 F.2d 667, 674 (7th Cir. 1992), the courts applied the quick look because, unlike this case, they were confronted with naked restraints on price or output. In *Lie v. St. Joseph Hosp.*, the court *refused* to apply an abbreviated rule of reason because the plaintiff failed to show a naked restraint and the challenged practice had a procompetitive purpose. 964 F.2d 567, 570 (6th Cir. 1992).

U.S. 321, 362 (1963); *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 235-36 (1st Cir. 1983). The Ninth Circuit's ruling will unquestionably have such a chilling effect. Prior to *CDA*, businesses could expect that a practice, which is not *per se* illegal or a naked restraint on price or output, is permissible, unless it is shown that its anticompetitive effects outweigh its procompetitive benefits. The Ninth Circuit's decision clouds that expectation. It permits a court to strike down a practice which has no effect on price or output and which has a procompetitive purpose.

CONCLUSION

For all the foregoing reasons, a writ of certiorari should be issued in this matter.

RAOUL RENAUD
CALIFORNIA DENTAL ASSOCIATION
1201 K Street Mall
P.O. Box 13749
Sacramento, CA 95853
(916) 443-0505

PETER M. SFIKAS
Counsel of Record
SCOTT M. MENDEL
ERIK F. DYHRKOPP
EDWARD M. GRAHAM
BELL, BOYD & LLOYD
70 West Madison Street
Suite 3300
Chicago, IL 60602-4207
(312) 372-1121

Attorneys for Petitioner

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